# IN-FLIGHT PHONE CANADA INC. 1994 ANNUAL REPORT

IN-FLIGHT PHONE
CANADA

# The Company

**In-Flight Phone Canada Inc.** is the exclusive Canadian licensee of In-Flight Phone Corporation ("In-Flight US"), the developer and operator of the world's first commercial, interactive video-based digital air-to-ground passenger communications system called *FlightLink*. In-Flight US is controlled by telecommunications giant MCI Communications, headquartered in Washington DC.

In-Flight Phone Canada is commercializing the technology for the Canadian market under one of three licenses awarded by the Canadian Government. *FlightLink* currently offers digital telephone, fax, data and Internet communication, stock quotes, video games, rental car and hotel reservations and a number of information and shopping services. The system will be expanded in the future to include live television news, sports and entertainment. In-Flight's revenue is derived from charges for system use by passengers of Canadian commercial airlines and private aircraft as well as from system use of *FlightLink* installed US based aircraft flying in Canadian airspace. In-Flight also generates revenue from the sale of digital telephone equipment to private aircraft operators.

In-Flight Phone Canada has an operating network of fourteen ground stations providing continuous coast to coast coverage. Combined with the network of 79 US ground stations, this allows In-Flight Phone Canada to offer full seamless, digital coverage across the continental US and Canada. In-Flight Phone Canada is selling systems to Canadian private aircraft operators as well as marketing to the commercial, charter and regional airlines.

*FlightLink* is an advanced, fully digital system that consists of seat back video screens, armrest mounted handsets, an on-board local area network and radio broadcast equipment, all of which combine to form a fully interactive communication, information and entertainment system. A network of ground stations supports the onboard equipment, linking to the land based public switch telephone networks and the In-Flight Phone North American control centre in Oakbrook Terrace, Illinois.

# 1994 Year in Review

1994 was an exciting and eventful year for In-Flight Phone Canada Inc. At the beginning of the year In-Flight Phone Canada's main assets were the air-to-ground communications license that was granted to the Company in 1992, the perpetual rights to In-Flight Phone Corporation's *FlightLink* technology and a coast to coast network of fourteen operating ground stations. During the year the following developments occurred:

### Sprint Canada Strategic Alliance

In May, Sprint Canada, a subsidiary of Call-Net Enterprises and one of Canada's largest long distance carriers, formed a strategic alliance and became an equity partner of the Company. Under a wide ranging agreement Sprint acquired common stock and options for additional common stock exercisable over the next three years. If all options are exercised Sprint Canada will become the largest shareholder of In-Flight Phone Canada with approximately 17% of the outstanding common stock. Through the agreement In-Flight Phone Canada received the right to use Sprint's logo and brand name. Sprint will also manage interconnect services from our ground stations to the ultimate call destination. Mr. Patrick Pichette, Vice President and Chief Financial Officer of Sprint Canada, serves on the Board of Directors of the Company.

### U.S. Developments

During the fourth quarter of 1994 MCI Communications Corporation ("MCI") the giant US telecommunications service provider ,completed the acquisition of a significant stake in In-Flight Phone Corporation ("In-Flight US"). This benefits your Company by having MCI's financial, technical and marketing power behind our group of companies. MCI will make significant contributions to the development of the communications network, new systems and services. MCI's role as an In-Flight Phone partner significantly enhances In-Flight Phone Canada's ability to develop our customer base.

On November 22,1994, Mr. Phil Bakes was appointed to the position of Chairman and Chief Executive Officer of In-Flight US. Mr. Bakes' previous experience included terms as President and CEO of Eastern Airlines from 1986 to 1990 and President of Continental Airlines from 1984 to 1986.

Also on November 22, 1994 Jack Goeken announced his resignation as Chairman and CEO of In-Flight US. A telecommunications pioneer, Mr. Goeken founded In-Flight Phone Corporation in 1989. He was also the founder of MCI, the FTD worldwide floral network, CML Satellite Corporation and Airfone. Jack founded the industry which our Company serves and we thank him for his guidance and insights during our Company's early development. Jack has since relinquished his role as Chairman Emeritus of In-Flight Phone Canada.

## Customers

On October 26, 1994 your Company announced its first commercial contract. We are delighted to have been awarded a ten year contract to install a *FlightLink* communication system on all of Air Atlantic's current and future fleet of regional aircraft, including its BAe-146 jets, new Jetstream 41's and Dash-8 turboprops. The contract calls for installations of *FlightLink* to begin in 1995. Air Atlantic is the Halifax based regional partner of Canadian Airlines International serving 0.5 million passengers annually.

Your Company continued to focus on opportunities in the commercial and charter air carrier markets during 1994 and believe that we have made significant progress toward achieving further market share in 1995.

*FlightLink* communication systems were sold to four corporate aircraft operators in 1994. Included in this growing customer base are Shell Canada, Husky Injection Molding, Loewen Group and Emergo. Revenue from system use began in early 1995. Further orders in this sector have been booked so far in 1995 and more are expected as we continue to aggressively develop our corporate aviation customer base. We are examining opportunities in the corporate aviation sector to expand the scope of our operations, and hope to report developments to our shareholders during 1995.

## Management

In July 1994, Mr. Lee Richardson joined the Company as President and works in concert with Peter Bolton, President and Chief Operating Officer of the Company's principal operating subsidiary. Lee is an Albertan who has had a distinguished career in private enterprise and public service. In the 1970's he served in numerous senior capacities for the Alberta Provincial Government and subsequently served as a member of Parliament in the House of Commons where he held key positions in Communications and Transport ministries.

Lee's focus is on setting strategic direction for the Company, leading financing initiatives and dealing with governmental and regulatory bodies. He also works closely with Peter Bolton to develop our commercial airline customer base.

## Office Relocation

In June 1994 we relocated our executive offices to Calgary to better serve our customers and to take advantage of the positive Alberta business environment.

## Financing

Effective June 30,1994 your Company's common shares began trading on the Alberta Stock Exchange under the symbol "IFL". The former listing on the Canadian Dealing Network under the symbol "IFPC" was relinquished. We believe that this move will benefit the Company's ability to attract new institutional and retail shareholders, and will positively impact our ongoing ability to access new equipment and working capital.

The Company undertook three financings in 1994 and recently completed a fourth early in 1995. All financings were designed to augment working capital to finance early operations and contract development. In February 1994 the Company completed a placement of Special Warrants at $0.80 per Special Warrant exercisable into common shares on a one-for-one basis for total proceeds of $1,735,800. In May, 1994 the Sprint Canada strategic aliance was completed pursuant to which the Company issued Special Warrents for total cash proceeds of $500,000. In October, 1994 a Rights Offering was completed for total proceeds of $1,615,887.

In February, 1995 your Company completed a private placement of 1,967,924 Special Warrants at $0.65 per Special Warrant for gross proceeds of $1,279,151. Each Special Warrant entitles the holder to acquire one common share without payment of additional consideration at any time after issuance. After June 30,1995, in certain circumstances, holders of Special Warrants may be entitled to receive 1.1 common shares for each Special Warrant exercised.

## Future Outlook

We remain optimistic about our prospects of achieving a major commercial airline contract in the near future. A significant amount of the Company's resources have been focused on this objective, and while we face fierce competition from large multinational communications conglomerates, we look forward to reporting on developments and our continued success in building the business.

The recently announced "Open Skies" agreement between Canada and the U.S. will have a positive impact on our potential revenue from U.S. based *FlightLink* installed aircraft flying over Canadian airspace. Three of the four commercial airline customers of In-Flight US have been awarded new transborder routes and have announced their intention to commence operations in the near future.

In-Flight US increased their rate of *FlightLink* installations in January 1995 and expect to have over 350 aircraft installed by the end of the summer in 1995 and close to 600 aircraft by year end. This is expected to significantly increase overfly revenue to your Company as the year progresses.

In-Flight US continues to market aggressively to U.S. airlines and we believe that they will further increase their market share in 1995.

I would like to take this opportunity to thank our employees, directors and advisors for their hard work and contribution to the Company over the past year. I would add a special thanks to our investors and shareholders who have enthusiastically supported the Company during this challenging period of opportunity and advancement.

Gerald S. Hurlow

Chairman and Chief Executive Officer

# Management's Discussion and Analysis of Financial Condition

## Year Ended December 31, 1994

During the year ended December 31, 1994 the Company's focus continued to be on the development of its general aviation and commercial airline marketing programs, and the development of its commercial activities.

Effective June 30,1994 the Company's common shares began trading on the Alberta Stock Exchange under the symbol "IFL". The former listing on the Canadian Dealing Network under the symbol "IFPC" was relinquished.

In the first quarter of 1994 the Company completed a placement of Special Warrants at $0.80 per Special Warrant exercisable into common shares on a one-for-one basis for total proceeds of $1,735,800. On May 31, 1994 a receipt for a final prospectus was received qualifying the newly created common shares for public distribution. Proceeds were used to provide working capital and reduce bank indebtedness and payables.

On October 21, 1994 a Rights Offering was completed for total proceeds of $1,615,887. The offering, allowed owners of common shares to subscribe for one new common share for every eight shares held and was oversubscribed. Proceeds were used to provide additional working capital.

In May 1994, Sprint Canada Inc. ("Sprint Canada"), a subsidiary of Call-Net Enterprises and Canada's largest alternative carrier of switched voice long distance services, became a strategic and equity partner of the Company. Under a wide ranging agreement Sprint Canada acquired common stock and options for additional common stock exercisable over the a three year period ending June 30, 1997. If all options are exercised Sprint Canada will become the Company's largest shareholder with approximately 17% of the outstanding common stock.

Sprint Canada acquired 1,625,000 common shares and 625,000 Purchase Warrants, each Purchase Warrant exercisable into 0.64 new common shares for $1.25 per common share through to and including June 30, 1995, for gross cash consideration of $500,000. Sprint Canada and the Company simultaneously entered into an agreement providing the Company with use of certain trademarks and logos of Sprint Canada. Sprint Canada exercised its full allotment of rights in October 1994, acquiring an additional 203,125 shares through the exercise of 1,625,000 rights. Sprint Canada acquired an additional 269,231 Class "B" Series I Special Warrants at $0.65 per Special Warrant under a private placement completed February 28, 1995.

Sprint Canada also received the right to nominate one director to the board of directors of the Company. Mr.

Patrick Pichette, Vice President and Chief Financial Officer of Sprint Canada, was appointed to the board on February 16, 1995.

On October 26, 1994 the Company announced its first commercial contract which provides for a ten year service agreement to install a *FlightLink* communication system on all of Air Atlantic's current and future fleet of regional aircraft, including its BAe-146 jets and Jetstream 41's. The contract calls for installations of FlightLink to begin in 1995. Air Atlantic is the Halifax based regional partner of Canadian Airlines International serving 0.5 million passengers annually.

The Company continued to focus on opportunities in the commercial and charter air carrier markets during 1994 and believes that it made significant progress toward achieving further market share in 1995.

In June, 1994 the Company reached an agreement with its affiliate, In-Flight Phone International, Inc. and In-Flight Phone Corporation, to amend the terms of the ground station loan facility and establish a repayment schedule. Reference is made to note 5 of the Notes to the consolidated Financial Statements. This action positively impacted working capital by deferring a significant amount due under current liabilities in accordance with the newly established repayment schedule.

*FlightLink* communication systems were sold to four corporate aircraft operators in 1994. Included in this customer base were Shell Canada, Husky Injection Molding, Loewen Group and Emergo. Revenue from system use will begin in 1995.

Total revenue during 1994 was $142,754 which related to the sale of equipment to corporate customers. General and administrative expenses of $1,767,459 were incurred, of which $806,239 were capitalized to deferred start-up costs in accordance with the Company's accounting policies. This compares to $1,001,233 for the year ended December 31, 1993 reflecting a 77% increase relating to larger scale of operations in 1994.

The Company changed its accounting treatment relating to deferral of start-up costs subsequent to April 30, 1994 at which time the Company was deemed to have commenced commercial operations. Ground station operating costs were $243,937 for the year ended December 31, 1994, up 207% from the previous year reflecting a full year's operations in 1994 for the entire Canadian ground station network.

Interest on long term debt due to the Company's US affiliate was $135,558 during 1994 as compared to nil in 1993, reflecting the commencement of interest accrual in 1994 in accordance with the terms of the ground station loan facility. Depreciation and amortization expense of $736,805 for the year ended December 31, 1994 relates to charges taken in respect of the amortization of deferred start-up expenses and depreciation of capital equipment.

Total losses were $2,865,180 in 1994, of which $806,239 was capitalized to deferred start-up costs and $10,958 was received as interest income on cash balances, resulting in a net loss for the year of $2,047,983.

Total capital expenditures during the year ended December 31, 1994 were $50,692 relating to the acquisition of computer equipment and hardware.

Net losses of $2,047,983 net of non-cash items of $736,805 offset by reductions in current liabilities of $295,410 resulted in a total cash requirement of $2,412,827 for 1994. This was financed by the issuance of common shares for cash aggregating $3,476,327, which together with the $1,000,000 capital stock issued for the acqusition of trademark rights from Sprint Canada Inc., resulted in the total issuance of capital stock of $4,476,327 during the year. Cash resources increased $1,012,808 for the year ended December 31, 1994. At year-end, the Company has cash and accounts receivable aggregating $507,338 and had no bank debt. The Company had a working capital deficiency of $102,971. Reference is made to "Liquidity and Cash Resources".

## Liquidity and Capital Resources

At December 31, 1994 the Company had a working capital deficiency of $102,971. Included in this deficiency were amounts due to related parties aggregating $335,510 comprised of $250,809 payable to In-Flight US, and $84,701 representing amounts due to officers.

In order to provide for ongoing operating and contract development expenses, the Company undertook a private placement in February, 1995 pursuant to which the Company received net proceeds after expenses of approximately $1,200,000. After giving effect to the Offering, the Company had positive working capital of approximately $1,100,000 which the Company believes will adequately meet operating costs and costs of development for a period of approximately six months through to and including August, 1995.

Working capital requirements in 1995 are expected to be in the amount of approximately $1.8 million. While the Company expects to begin generating revenues and net operating margins on installation which will begin in Air Atlantic in late 1995 and from its installations in the corporate aircraft sector, the Company's working capital requirements will require additional external financing in the second half of 1995. Working capital requirements will be dependent on the extent to which the Company is successful in developing its commercial airline contract opportunities during 1995.

The majority of the Company's past capital expenditures were made in 1993 when the Company installed its national network of 14 ground stations. Future capital expenditures are expected to relate primarily to costs of capital equipment and costs of installation to fulfill commercial airline contracts which the Company is presently pursuing with operators of commercial and charter airlines. Such contracts may require the installation of additional ground station sites and certain non-recurring engineering costs in addition to the cost of airborne equipment and installation costs. Such costs will, in aggregate, be financed in the future from capital financings and as such the Company's ability to fulfill these contracts will be contingent upon the availability of sufficient capital.

Carson J. Wynne
Senior Vice President, Finance & Chief Financial Officer

## AUDITORS' REPORT

To the Directors of **In-Flight Phone Canada Inc.**:

We have audited the consolidated balance sheets of **In-Flight Phone Canada Inc.** as at December 31, 1994 and 1993 and the consolidated statements of loss and deficit and changes in financial position for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1994 and 1993 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

Deloitte & Touche

Calgary, Alberta
February 28, 1995

Chartered Accountants

## IN-FLIGHT PHONE CANADA INC.

### Consolidated Statements of Loss and Deficit

| | Years Ended December 31, 1994 $ | 1993 $ |
|---|---|---|
| **Revenue** | | |
| Communication system sales | 142,754 | - |
| Cost of communication system sales | 124,175 | - |
| | 18,579 | - |
| **Expenses** | | |
| Depreciation and amortization | 736,805 | 29,856 |
| General and administration | 1,767,459 | 1,001,233 |
| Ground stations | 243,937 | 79,469 |
| Interest on long-term debt | 135,558 | - |
| | 2,883,759 | 1,110,558 |
| Loss before the following | (2,865,180) | (1,110,558) |
| Amounts capitalized to deferred start-up costs or licence and technology rights | 806,239 | 1,110,558 |
| Interest income | 10,958 | - |
| **NET LOSS AND DEFICIT, END OF YEAR** | (2,047,983) | - |
| Loss per share | (0.09) | (0.00) |

## IN-FLIGHT PHONE CANADA INC.

### Consolidated Balance Sheets

| | December 31, 1994 $ | 1993 $ |
|---|---|---|
| **ASSETS** | | |
| **Current Assets** | | |
| Cash | 410,377 | 1,374 |
| Accounts receivable | 96,961 | 58,835 |
| Prepaid expenses | 176,158 | 19,268 |
| Inventory | 195,284 | - |
| | 878,780 | 79,477 |
| Capital assets (Note 3) | 2,424,725 | 2,562,481 |
| Deferred start-up costs (Note 4) | 1,689,781 | 1,387,656 |
| Trademarks and licences | 1,188,960 | 202,457 |
| Other | 221,092 | 149,574 |
| | 6,403,338 | 4,381,645 |
| **LIABILITIES** | | |
| **Current Liabilities** | | |
| Bank indebtedness | - | 603,805 |
| Accounts payable and accrued liabilities | 635,276 | 540,386 |
| Current portion of long-term debt (Note 5) | 346,475 | 934,744 |
| | 981,751 | 2,078,935 |
| Long-term debt (Note 5) | 1,943,143 | 1,252,610 |
| | 2,924,894 | 3,331,545 |
| **SHAREHOLDERS' EQUITY** | | |
| Share capital | | |
| Common shares (Note 6) | 5,526,427 | 1,050,100 |
| Deficit | (2,047,983) | - |
| | 3,478,444 | 1,050,100 |
| | 6,403,338 | 4,381,645 |

**APPROVED BY THE BOARD**

....................................................Director

....................................................Director

# IN-FLIGHT PHONE CANADA INC.

## Consolidated Statements of Changes in Financial Position

| | Years Ended December 31, 1994 $ | 1993 $ |
|---|---|---|
| **Net inflow (outflow) of cash related to the following activities:** | | |
| **Operating** | | |
| Net loss | (2,047,983) | - |
| Add items not affecting cash | | |
| Depreciation and amortization | 736,805 | 29,856 |
| Changes in non-cash operating working capital items | (295,410) | 245,894 |
| | (1,606,588) | 275,750 |
| Start-up costs incurred | (806,239) | (1,110,558) |
| | (2,412,827) | (834,808) |
| **Financing** | | |
| Increase in equipment loans | - | 2,187,354 |
| Issuance of common stock (Note 6) | 4,476,327 | 1,050,000 |
| Increase in deferred foreign exchange loss | - | (22,122) |
| Net change in amounts due to/from related parties | - | 67,560 |
| | 4,476,327 | 3,282,792 |
| **Investing** | | |
| Acquisition of capital assets | (50,692) | (2,574,832) |
| Acquisition of Canadian Patricia Exploration Ltd. (Note 1) | - | (141,613) |
| Acquisition of trademark rights (Note 6) | (1,000,000) | - |
| | (1,050,692) | (2,716,445) |
| **NET CASH INFLOW (OUTFLOW)** | 1,012,808 | (268,461) |
| **Cash position (net bank indebtedness), beginning of year** | (602,431) | (333,970) |
| **Cash position (net bank indebtedness), end of year** | 410,377 | (602,431) |

## 1. BASIS OF PRESENTATION

In-Flight Phone Canada Inc. (the "**Company**") was formed in April 1992 to develop and operate in Canada an all-digital air-to-ground passenger communications system called "FlightLink".

The Company was a private corporation until April 1993 when it effected a reverse take-over of Canadian Patricia Exploration Ltd. ("**CPE**"), an issuer reporting in British Columbia and Ontario. CPE subsequently adopted the name In-Flight Phone Canada Inc. Subsequent to the reverse takeover, the shares of the Company traded on The Canadian Dealing Network. The shares of the Company were listed for trading on The Alberta Stock Exchange in June 1994.

Under accounting for a reverse take-over, the net assets of CPE were included at fair market value at the date of acquisition. These were comprised of assets of $1,001, liabilities of $49,827, and a net deficiency of $48,826. Acquisition costs of $92,787 and the net deficiency of $48,826 were allocated to goodwill.

These financial statements include the accounts of the Company and its wholly-owned subsidiaries, Affinity Corporation and In-Flight Phone (Canada) Corporation.

## 2. SIGNIFICANT ACCOUNTING POLICIES

### Inventory

Inventory, which consists of communication devices for planes, is recorded at the lower of cost and net realizable value.

### Deferred start-up costs

Prior to April 30, 1994, the Company was in the development stage, and, accordingly, all costs were deferred and capitalized. The Company's commercial operations began May 1, 1994, at which time costs attributed to the current period are recognized as current expenses.

Deferred start-up costs are being amortized on a straight-line basis over three years commencing May 1, 1994.

### Licence and technology rights

Costs incurred to obtain the licence and negotiate the technology rights have been capitalized and will be amortized on a straight-line basis over ten years commencing May 1, 1994.

## 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Trademark rights

The trademark rights will be amortized over a period of 10 years commencing on the date of the first installation of air-to-ground communication equipment.

### Capital assets

Capital assets are recorded at cost and are depreciated at the following annual rates:

| | |
|---|---|
| Computer, furniture and equipment | 20% declining balance |
| Ground stations | 10% straight line commencing May 1, 1994 |

### Foreign exchange

Foreign currency exchange losses relating to the translation of long-term liabilities are deferred and amortized on a straight line basis over the remaining life of the related liability.

### Goodwill

Goodwill represents the excess of the purchase consideration over the fair value of the net assets of CPE acquired in April 1993. Goodwill is being amortized on a straight line basis over 10 years.

## 3. CAPITAL ASSETS

| | December 31, | | | |
|---|---|---|---|---|
| | Cost $ | Accumulated Depreciation $ | 1994 Net Book Value $ | 1993 Net Book Value $ |
| Furniture and equipment | 88,501 | 27,978 | 60,523 | 48,045 |
| Computer | 34,799 | 9,907 | 24,892 | 14,735 |
| Ground stations | 2,506,404 | 167,094 | 2,339,310 | 2,499,701 |
| | 2,629,704 | 204,979 | 2,424,725 | 2,562,481 |

## 4. DEFERRED START-UP COSTS

| | December 31, 1994 $ | December 31, 1993 $ |
|---|---|---|
| Start-up costs | 1,701,049 | 894,810 |
| Financing costs | 492,846 | 492,846 |
| | 2,193,895 | 1,387,656 |
| Less amortization | 504,114 | - |
| | 1,689,781 | 1,387,656 |

## 5. LONG-TERM DEBT

Long-term debt is comprised of an equipment loan due to In-Flight Phone International Inc., a shareholder. The loan is partially secured by 14 ground stations. The loan bears interest at a rate of U.S. prime plus 2½ %, and payments are due commencing December 1994.

| | December 31, 1994 Cdn. $ | December 31, 1993 Cdn. $ |
|---|---|---|
| Principal | 2,289,618 | 2,187,354 |
| Current portion | 346,475 | 934,744 |
| Long-term portion | 1,943,143 | 1,252,610 |

The first principal payment of $125,000 U.S. was due December 31, 1994 and was not paid at that time. The parties have entered into discussion regarding rescheduling the payments. Principal payments due in 1994 and over the next six years are as follows:

| | U.S. $ | Cdn. $ |
|---|---|---|
| 1994 | 125,000 | 173,237 |
| 1995 | 125,000 | 173,238 |
| 1996 | 250,000 | 346,475 |
| 1997 | 250,000 | 346,475 |
| 1998 | 250,000 | 346,475 |
| 1999 | 250,000 | 346,475 |
| Subsequent to 1999 | 402,080 | 557,243 |
| | 1,652,080 | 2,289,618 |

## 6. SHARE CAPITAL

| | 1994 | | 1993 | |
|---|---|---|---|---|
| | Shares | $ | Shares | $ |
| Balance, beginning of year | 17,750,112 | 1,050,100 | 2,652,634 | 100 |
| Consolidation of CPE shares at 10.2 for 1 | - | - | (2,402,522) | - |
| Issued for cash, net of costs of $375,260 (1993 - NIL) | 5,487,861 | 3,476,327 | 2,500,000 | 1,050,000 |
| Issued to In-Flight shareholders on reverse take-over | - | - | 15,000,000 | - |
| Issued for trademark | 1,000,000 | 1,000,000 | - | - |
| Issued to former CPE shareholders | 23 | - | - | - |
| Balance, end of year | 24,237,996 | 5,526,427 | 17,750,112 | 1,050,100 |

i) On February 11, 1994, the Company issued 2,169,750 special warrants for cash consideration of $1,735,800. During 1994, the special warrants were exercised and the Company issued 2,169,750 common shares. Costs associated with this issue amounted to $260,248.

ii) On May 18, 1994, the Company entered into an agreement with Sprint Canada Inc. in which the Company was granted the right to use the Sprint trademark for consideration of 1,000,000 common shares. The shares were valued at $1,000,000 at the date of the transaction. The Company also issued to Sprint, for an aggregate consideration of $500,000, 625,000 Class A Special Warrants, each Class A Special Warrant entitling the holder thereof to receive at no additional cost one common share and one Class I Purchase Warrant. All of the 625,000 Class A Special Warrants were exercised and 625,000 common shares and 625,000 Class I Purchase Warrants were issued in 1994. Class I Purchase Warrants entitle the holder to acquire 0.64 common shares for each Class I Purchase Warrant exercised upon payment of $1.25 to the Company at any time until May 18, 1995.

iii) In October 1994, the Company issued 2,693,111 common shares pursuant to a rights offering circular dated September 16, 1994 for gross proceeds of $1,615,887. Costs of this issue amounted to $115,012.

iv) During 1994 an additional 23 common shares were issued on conversion of Canadian Patricia Exploration Ltd. shares.

v) As at February 16, 1995, the Company had stock options outstanding for the purchase of 2,330,000 common shares at prices ranging from $.50 to $1.00 and expiring in 1998 and 1999.

## 6. SHARE CAPITAL (Continued)

vi) Pursuant to an agreement dated as of November 24, 1994, the Company issued to a Canadian securities dealer an option to acquire up to 500,000 common shares, exercisable on or before November 24, 1996, at an exercise price of $1.00 per common share. Such option was issued in consideration for advice and services rendered in assisting in negotiations with a major Canadian airline carrier and with respect to corporate finance matters. The option is not exercisable until the Company enters into a definitive written agreement or agreements with such major Canadian airline carrier for the installation of the FlightLink system on not less than 40 Boeing 737 commercial passenger jet aircraft or commercial jet aircraft having an equivalent or greater seating capacity to the Boeing 737.

## 7. RELATED PARTY TRANSACTIONS

The following transactions took place between the Company and shareholder corporations or companies controlled by directors:

| | Years Ended 1994 $ | Years Ended 1993 $ | 9 Months Ended 1992 $ |
|---|---|---|---|
| <u>In-Flight Phone International Inc.</u> | | | |
| Acquisition of inventory for resale | 311,667 | - | - |
| Interest on equipment loan | 135,558 | - | - |
| <u>Companies controlled by directors</u> | | | |
| Office rent | 28,500 | 21,000 | 20,250 |
| Consulting fees | 120,000 | 166,000 | 75,000 |
| Guarantee fee | 15,000 | 10,000 | - |

Included in accounts payable is a balance due to In-Flight Phone International Inc. in the amount of $250,809 (1993 - $114,435), amounts due to officers of $74,701, and a balance due to a company controlled by a director and shareholder in the amount of $10,000.

## 8. TAX LOSS CARRYFORWARDS

The Company has non-capital losses of approximately $3.3 million available to reduce future taxable income. The benefit of these loss carryforwards has not been reflected in these financial statements.

## 9. COMMITMENTS AND CONTINGENCIES

### (a) Rights to FlightLink

The Company, through its indirect wholly-owned subsidiary, In-Flight Phone (Canada) Corporation, obtains its exclusive Canadian rights to the FlightLink system pursuant to an international technology rights agreement among the Corporation, In-Flight International and In-Flight US dated August 1, 1992 (the **"Rights Agreement"**).

The Rights Agreement is a form of license for the exclusive marketing and distribution of the FlightLink system in Canada. The Rights Agreement has an initial term of 10 years with automatic renewals in perpetuity for successive five year periods on the same terms and conditions, provided that the Company is not in material default of any of its obligations thereunder.

The Rights Agreement provides for a 15% gross revenue royalty and a 15% gross profit margin on equipment acquired from In-Flight International. The Company is required to use its best efforts to diligently market, sell and promote the FlightLink system, comply with all laws and regulations and pay the above-noted royalties. The Company does not acquire any direct rights to the FlightLink system technology, trademarks or associated goodwill.

### (b) Sprint Canada Inc. Strategic Alliance

On May 18, 1994 the Company entered into an agreement (the **"Sprint Agreement"**) with Sprint Canada Inc. (**"Sprint"**). The Sprint Agreement is a wide-ranging agreement which deals with a variety of matters, including the following: The granting by Sprint of a sub-license to the Company in the form of a sub-license agreement dated as of May 18, 1994 (the **"Sub-License Agreement"**) between the Company, Sprint, Call-Net Enterprises Inc. and Sprint Communications Company L.P., permitting the Company to use certain of Sprint's trademarks in the air-to-ground communication sector in Canada for the purposes of marketing the Company's services to commercial and charter airlines, corporate aircraft operators and airline passengers. The sub-license is for an initial term of two years from the agreement closing and is automatically renewable up to and including August 4, 2003 if the Company meets certain prescribed terms and conditions on or before the expiry of the initial term. The consideration for the grant of the sub-license to the Company includes the issuance of 1,000,000 common shares, having an aggregate value equivalent to $1,000,000, by In-Flight to Sprint; the payment by In-Flight of a royalty equal to 10% of the amounts payable to Sprint for the provision of certain services by Sprint to the Company; and the granting by In-Flight to Sprint of a right of first refusal on future issuances of securities by In-Flight.

## 9. COMMITMENTS AND CONTINGENCIES (Continued)

### (c) Air Atlantic Agreement

On October 20, 1994 the Company, through its indirect wholly-owned subsidiary, In-Flight Phone (Canada) Corporation, entered into an agreement with Air Atlantic Ltd. (the "**Air Atlantic Agreement**"), a regional partner of Canadian Airlines, to install the FlightLink communications system on all aircraft in the fleet at a cost of approximately $1,000,000. The Air Atlantic Agreement has a 10 year term and covers all aircraft additions to the fleet during the life of the contract.

### (d) Operating Leases

The Company is committed, under terms of operating leases on its ground station sites, to the following payments:

| | $ |
|---|---|
| 1995 | 75,471 |
| 1996 | 56,746 |
| 1997 | 22,254 |
| 1998 | 16,606 |
| 1999 | 9,900 |

## 10. SUBSEQUENT EVENT

Pursuant to agreements dated February 16, 1995 (the "**SAR Agreements**") In-Flight has issued to two of its executive officers 400,000 stock appreciation rights entitling each such holder to a cash payment by In-Flight of an amount equal to the difference between $0.75, the closing price of the common shares on the ASE on February 16, 1995, and the closing price of the common shares on the ASE on the trading day prior to the exercise of such rights by the holder thereof. The holder is entitled to exercise his rights at any time up to and including the expiry of such rights on February 16, 2000.

On February 28, 1995, the Company closed a private offering of 1,967,924 Class B special warrants, Series I for gross proceeds of $1,279,151. Each warrant entitles the holder to receive at no additional cost, one common share on or before July 31, 1995. In the event that a receipt for a prospectus (to qualify the shares) is not issued on or before June 30, 1995, then the Class B Special Warrant, Series I holder is entitled to 1.1 common share for each special warrant exercised.

## Corporate Information


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## Executive Officers & Directors

Gerald S. Hurlow
Chairman & CEO

Lee S. Richardson
President

Carson J. Wynne
Senior Vice President & CFO

Neal F. Meehan
Executive Vice President
In-Flight Phone Corporation

Peter W. Bolton
President & COO, In-Flight Phone
Canada Corporation

Clifford S. Malone
Director

Gordon W. Walker, Q.C.
Director

Michael Palmer
Director

Daniel P. Shapiro
Director

Patrick Pichette
Vice President and CFO,
Sprint Canada Inc.

## Transfer Agent:

The R-M Trust Company, Toronto, Ontario and Calgary, Alberta

## Auditors:

Deloitte & Touche, Calgary, Alberta

## Shares Listed:

Alberta Stock Exchange Symbol: IFL